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No. 460

# In the Supreme Court of the United States

OCTOBER TERM, 1953

WALTER F. O'BRIEN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 1a–9a) [1] are reported at 38 T.C. 707. The *per curiam* opinion of the court of appeals (Pet. 12) is reported at 319 F. 2d 532.

### JURISDICTION

The judgment of the court of appeals was entered on July 31, 1963. (Pet. 2.) The petition for a writ of certiorari was filed on September 10, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] Record references are to the appendix to the taxpayer's brief in the Court of Appeals.



707-875—63——1

## QUESTIONS PRESENTED

Taxpayer sued his employer for wrongful discharge and recovered a judgment for back pay. He elected to spread back the recovery over the earlier years, in accordance with § 1303 of the Internal Revenue Code of 1954. The questions presented are:

1. Whether, in reallocating the recovery to the prior years for purposes of § 1303, the taxpayer may also reallocate to the same years any deduction for legal expenses incurred in obtaining the recovery.

2. Whether the portion of the recovery paid over by the taxpayer to his attorney pursuant to a contingent-fee contract may be excluded from the taxpayer's gross income or whether the entire recovery must be included in income with the legal fees being taken as a deduction.

## STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

* * * * *

SEC. 1303. INCOME FROM BACK PAY.

(a) *Limitation on Tax.*—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross in-

come for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, as determined under regulations prescribed by the Secretary or his delegate.

(b) *Definition of Back Pay.*—For purposes of this section, the term "back pay" means amounts includible in gross income under this subtitle which are one of the following—

(1) Remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed before the taxable year for his employer and which would have been paid before the taxable year except for the intervention of one of the following events:

* * * * * *

(B) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings;

* * * * * *

## STATEMENT

In 1952, petitioner was discharged from his position as an employee of the United States. He engaged an attorney to contest the discharge on the following terms (R. 2a):

> Walter F. O'Brien hereby engages Edwin J. McDermott as his Attorney with the right to engage associates to represent him, said Walter F. O'Brien, in his action to recover damages from the United States arising out of his sepa-

> ration from the classified Civil Service of the United States as of January 14, 1952.
>
> It is agreed that for his said service Edwin J. McDermott shall receive 50% of any amount of damages or any other sums of money received by way of suit or settlement or otherwise.

In 1957, as a result of the attorney's efforts, petitioner was reinstated in his job and obtained a judgment in the Court of Claims for $16,173.05, representing back pay for the years 1952 through 1955. Upon receiving a check for that amount, petitioner endorsed the check over to his attorney and received back from him a check for $7,929.95, the difference of $8,243.10 being retained by the attorney in payment of his fee and other costs (R. 2a–3a).

In his income tax return for 1957, petitioner computed his tax under § 1303 of the Internal Revenue Code of 1954, which provides generally that the tax attributable to amounts received as back pay for prior years shall not exceed the tax that would have been due had the amounts been received in the prior years. In applying that provision, petitioner "spread back" to 1952–1955 not only the back pay attributable to those years (*i.e.*, the $16,173.05 received under the judgment) but also, as a partially offsetting deduction, the legal fees incurred in the litigation ($8,243.10). The full Tax Court, sustaining a deficiency determined by the Commissioner, held that, notwithstanding the reallocation of the back pay to the years to which it was attributable (1952–1955), the legal fees could be treated as a deduction only for the year in which paid (1957). The court of appeals affirmed *per curiam*. (R. 3a–6a, 9a; Pet. 12.)

## ARGUMENT

1. Section 1303, like all of the provisions permitting a "spread-back" of various kinds of "bunched" income (§§ 1301-1307), applies only to amounts included "in gross income" and operates by constructively including the amounts "in gross income" for prior years. There is nothing in the provision authorizing related deductions to be spread back along with the gross income or—what amounts to the same thing—limiting the amounts to be reallocated to prior years to the *net* income from the recovery. The language relied upon by petitioner (§ 1303(b)(1)(B), Pet. 9–10) is patently irrelevant, being concerned only with the definition of the kind of income eligible for relief, not with the method of computing the limitation once eligibility is established. There is in any event no conflict of decisions or other reason for review of the question by this Court.

2. Alternatively, petitioner argues that only the net amount he retained out of the judgment after paying his attorney was includible in *gross* income. The argument is based on the decision of the Fifth Circuit in *Cotnam* v. *Commissioner*, 263 F. 2d 119, with which the decision in this case is said to be in conflict.

The *Cotnam* case involved a similar question under another of the "bunched income" provisions (what is now § 1301). The court there held that the portion of a judgment that was paid to the plaintiff's attorneys under a contingent-fee arrangement was not includible in the plaintiff's gross income, so that only the portion retained by the plaintiff was required to be reallocated

to the prior years. In so holding, the court construed the contingent-fee arrangement as having effected, at the time it was made, an assignment of a portion of the cause of action to the attorneys—*i.e.*, a completed transfer of ownership of a part of the claim.[2] From that premise, the court reasoned that the amounts realized on the portion of the claim owned by the attorneys was income to them and not to the plaintiff, rejecting the government's argument that under familiar assignment-of-income principles the income realized remained taxable to the plaintiff notwithstanding the assignment.

In this case, no assignment of the claim was ever made, and there is thus no occasion to reach the

[2] The controlling opinion of Judges Rives and Brown in the *Cotnam* case stated that the plaintiff, "in effect, assigned to her attorneys forty per cent of the claim"; that she had "to transfer a part" of the claim to the attorneys; that "she had to part with forty percent of her claim long before the realization of any income from it"; that the part of the proceeds paid to the attorneys "did not pass through her hands"; that she had not "obligated herself to pay the attorneys' fee" but, rather, the fee "was fully paid by the assignment of a portion of a doubtful claim"; and that she had "transferred a part interest in [the] tree to her attorneys, who then rendered the services necessary to bring forth the fruit" (263 F. 2d at 125–126). Judge Wisdom's explanation in announcing the decision (from which he himself dissented) is less clear in its import, but it seems to be based on a construction of an Alabama attorneys'-lien statute (to which there is no parallel in Pennsylvania) as working "an equitable assignment" and giving the attorney, not merely a lien, but "an equity in the cause of action" (*id.* at 125). Inasmuch as Judge Wisdom dissented on the issue while Judges Rives and Brown expressed their own views, however, Judge Wisdom's explanation of the decision has an uncertain status.

question of the effect of such an assignment. The contingent-fee contract (*supra*, pp. 3–4) constituted merely a promissory undertaking by petitioner to pay the attorney for his services 50% of any money received on the claim; it in no way purported to make a present, completed assignment of an ownership interest in the cause of action itself. Nor, for that matter, could it have done so, for any purported assignment of such a wage claim against the United States would plainly be ineffective under the Anti-Assignment Act, R.S. § 3477, 10 Stat. 170, as amended, 31 U.S.C. 203. Since petitioner thus continued to own the claim at all times and was subject only to a contractual commitment to pay his attorney a fee equal to 50% of the proceeds, there can be no question that the entire proceeds were includible in petitioner's income and the attorney's fees were entitled to be taken into account only by way of a deduction for the cost of collecting the income (§ 212(1), 1954 Code). And that is true whatever the result would have been if, as was thought to be the case in *Cotnam*, there had been a prior assignment of the claim itself.

Nor, of course, can the *Cotnam* case be said to be in conflict on the question whether the contingent-fee arrangement did operate as an assignment. While the Fifth Circuit in the *Cotnam* case did not articulate the grounds for its conclusion that a part of the claim had been assigned to the attorneys, the conclusion in its very nature could only be one about the effect of the particular arrangement under the local law (there,

Alabama law) governing assignments. The effect of the contract in this case under Pennsylvania and federal law is necessarily a different question.

## CONCLUSION

The decision below is correct and, for the reasons stated, the petition for certiorari should be denied.

Respectfully submitted.

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